My Top 3 Short Plays for 2017

Description

We’re now in the second quarter, and it may be a little late to run an article highlighting three short plays for 2017, but investors on the lookout for overvalued stocks are always looking, so I thought I would share my list with my fellow Foolish readers.

Marijuana stocks

I have written about **Canopy Growth Corp.** (TSX:WEED) in the past with a number of pieces on the company’s fundamentals, its long-term prospects, supply and demand issues in the cannabis industry, competition within the cannabis industry, stock options and dilution over time, unease as to the regulations involved in decriminalizing marijuana, and a slew of other reasons why Canopy is likely to underperform or at least underwhelm in the long term.

With valuations for most marijuana stocks sky-high (and I consider Canopy to be one of the most overvalued of the bunch), it may not take an epic crash to see stock prices dip dramatically; rather, I expect reduced growth expectations and more realistic research provided by larger institutions will begin to shed light on the long-term fundamentals of the business, leading to downward pressure on free cash flow projections and the consensus long-term growth rate, affecting marijuana companies’ equity valuations in a serious way.

Non-prime, sub-prime, high-risk lenders

One of the facets of the build up toward the ’07/’08 financial crisis was a wide-spread mentality that housing prices will continue to rise, and the provision for credit losses a company must keep on its books should reflect “improving conditions” in the real estate market, rather than key long-term risk factors facing lenders.

The Canadian real estate market has traditionally been a “slow and steady” market, resembling some European countries in terms of risk management and the strength of national banks in managing risk.

I am not talking about Canada’s big banks when I talk about what is happening with niche lenders in Canadian real estate. A significant portion of overall lending for residential mortgages and commercial mortgages is happening through non-prime-focused lenders such as **Home Capital Group Inc.** (TSX:HCG) and **Equitable Group Inc.** (TSX:EQB), targeting borrowers with low or no credit, recent immigrants, and those with small equity down payments.

These lenders employ ROE-boosting strategies aimed at increasing returns with little emphasis given to appropriate risk-management measures (a provision for credit losses of 0.04% or similar cannot reflect the reality of the risk profile of the company's portfolio of loans). These companies currently securitize a large portion of the loans on (and off) its books, creating mortgage bonds in partnership with the Canada Mortgage Bond program, allowing the company to sell off some of its worst-performing loans to institutions (while retaining an interest in many of these products).

With investor scrutiny arising for companies such as Home Capital and Equitable Group due to a number of recent scandals, inquiries into the lender's business practices may yield further insights into how and why many of these issues have arisen, and what is being done to remedy them in the long term.

Bottom line

I follow dozens of companies closely, and these three are the ones that I believe offer too much risk with a limited upside potential. Investors should do their own research and dig into the notes and fine print of every investment opportunity before moving forward.

Stay Foolish, my friends.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:HCG (Home Capital Group)
2. TSX:WEED (Canopy Growth)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Yahoo CA

Category

1. Investing

Date
2025/08/06
Date Created
2017/04/11
Author
chrismacdonald